STATE BOARD OF EQUALIZATION

August 5, 1993

Your letter dated March 24, 1993 has been forwarded to the Legal section for a response. According to the information in your letter and in our file, your client leases heavy construction equipment which it had purchased ex tax. If the lessee of the equipment has a licensed operator, the lessee may lease the equipment without an operator. If the lessee does not have a licensed operator, your client provides the licensed operator. Only a licensed operator may operate the equipment.

The issue raised by your letter is whether those transactions in which your client provides the licensed operator are leases or services.

A. Application of Tax to Leases of Tangible Personal Property

In California the general rule is that a lease of tangible personal property is a continuing sale and purchase. The lessor must collect use tax from the lessee at the time rentals are paid and pay the tax to the state. The use tax is measured by the rentals payable. Rev. & Tax. Code §§ 6006(g), 6006.1, 6010(e), and 6010.1 and Regulation 1660(c) (1). Since a lease is a continuing sale and purchase, the lessor may purchase the property ex tax by issuing a resale certificate to the seller.

For certain types of tangible personal property, however, the lessor may elect to pay tax on the purchase price of the property rather than on rental receipts. This is the tax-paid lease exception. It applies to a lease of tangible personal property which is leased in substantially the same form as acquired and for which the lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property. Rev. & Tax. Code §§ 6006(g) (5) and 6010(e) (5).

The application of tax to sales and leases of mobile transportation equipment (MTE) is different from other tangible personal property.[1]

[1]Revenue and Taxation Code section 6023 defines mobile transportation equipment as equipment such as railroad cars and locomotives, buses, trucks (except lIone-way rental trucks"), truck trailers, dollies, bogies, chassis, reusable cargo shipping containers, aircraft and ships, and tangible personal property which is or becomes a component part of such equipment. MTE does not include passenger vehicles, trailers and baggage containers designed for hauling by passenger vehicles, or "one-way rental trucksll as defined in section 6024.

A lease of MTE is never a sale and purchase. Rev. & Tax. Code § 6006(g) (4) and 6010(e) (4). Thus, a sale of MTE to a purchaser who subsequently leases the MTE is not a sale for resale. Under the Revenue and Taxation Code, however, a purchaser of MTE who limits his or her use of the MTE to leasing may issue a resale certificate when purchasing the MTE and make an election to pay use tax measured by the fair rental value of the MTE. The election is made by reporting tax measured by the fair rental value on a timely filed return for the period in which the MTE is first leased. Tax must thereafter be paid with the return for each reporting period, measured by the fair rental value, whether the MTE is within or without the state. The election may not be revoked with respect to the MTE as to which it is made. Rev. & Tax. Code §§ 6092.1, 6094(d), 6243.1, and 6244(d).

B. Lease v. Service

The Board's staff applies the following rules with respect to tangible personal property provided by one party to another:

> 1. If temporary possession and control of tangible personal property is transferred by one person to another for a consideration and the transferor does not provide an operator for the property, the transaction generally is a lease.
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> 2. If the owner of the property always provides the operator, i.e., the owner will not provide the property without its own operator, the transaction is not a lease. The charges made by the owner are regarded as charges for nontaxable services. The owner of the property should not purchase such property for resale. If the owner does issue a resale certificate when purchasing such property, the owner is liable for use tax measured by the purchase price when it first uses the property for any purpose other than retention, demonstration, or display. Rev. & Tax. Code § 6094(a).
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> 3. If the person desiring to use the property has the option to obtain the property with or without an operator, the transaction is a lease even if the owner of the property provides the operator. In those transactions in which the owner of the property provides the operator and the lease payments are subject to tax, the measure of tax will include the charges for rent but will not include the charges for the operator's services.

The California Supreme Court addressed the issue of whether a transaction was a lease in Entremont v. Whitsell (1939) 13 Cal.2d 291. In concluding that the contract was not for the lease of the equipment, the Court stated:

> "This conclusion follows from the fact that under the contract the possession and control of the trucks and the operators did not pass to the department - the operators did not become the employees of the

> department - but such possession and control remained in --- The chief characteristic of a renting or a leasing is the giving up of possession to the hirer, so that the hirer and not the owner uses and controls the rented property. (Civ. Code, sees. 1925, 1955.) The record is clear that the only supervision exercised by the department over the operators of the trucks was to direct them where to load and unload the material hauled, when to go on or leave the job, and to inform the operators whether the load should be dumped or spread. The department had no power to discharge the drivers - that power, and the power of selection, rested in ---. That is a factor of some importance in ascertaining whether --- or the department controlled the operators.... " (Id. at 295. Emphasis added.)

In the third type of transaction we described above, the person contracting with the owner of the property has the power of selection. Even where the person's selection is limited to hiring a licensed operator, that person still has the power of selection and therefore is regarded as having possession and control over the operator and equipment.

The staff's position on the third type of transaction benefits lessors such as your client because the lessor generally has the election to pay tax up front on the purchase of the equipment or to pay tax measured by rentals payable or the fair rental value of the equipment. Your client took advantage of this election by purchasing its equipment ex tax. If such transactions were regarded as services, your client would have to pay tax on the full purchase price of the equipment.

If you have further questions regarding Sales and Use Tax Law, please do not hesitate to write again.

Sincerely,

Elizabeth Abreu
Tax Counsel

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